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Securities Regulation—Rule 10b-5—Implied Private Cause of Action—Standing—Purchaser or Seller Requirement—Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)

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SECURITIES REGULATION—RULE 10b-5—IMPLIED PRIVATE CAUSE OF ACTION—STANDING—PURCHASER OR SELLER REQUIREMENT—*Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

On June 9, 1975, in *Blue Chip Stamps v. Manor Drug Stores*,¹ the United States Supreme Court carved out a new niche for itself in the annals of judicial conservatism, by “grav[ing] into stone *Birnbaum’s* arbitrary principle of standing.”² Since the promulgation of rule 10b-5³ in 1942, and especially since the decision in *Birnbaum v. Newport Steel Corp.*,⁴ in 1952, both federal courts and legal writers have produced voluminous dissertations on the scope and effect of this rule,⁵ which requires a plaintiff in a rule 10b-5 suit to be either a purchaser or seller of the securities involved.⁶ Generally the courts have favored the strict

1. 421 U.S. 723 (1975).

2. *Id.* at 761 (Blackmun, J., dissenting) (footnote omitted).

3. Rule 10b-5, 17 C.F.R. § 240.10b-5 (1975) provides:

It shall be unlawful for any person

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which there were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Securities Exchange Act of 1934 § 10b, 15 U.S.C. § 78j(b) (1970), provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

4. 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

5. *See, e.g.*, comments cited in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 768-69 n.3 (1975) (Blackmun, J., dissenting).

6. *Birnbaum* involved a shareholders’ derivative suit which essentially attacked a breach of fiduciary duty by corporate insiders. The primary defendant, Feldmann, was both president and controlling shareholder of Newport Steel Corporation. He abused this power by refusing to consummate a merger which would have been highly profitable to all the shareholders. Instead, he sold his own shares to another defendant, Wilport Company, at twice the then market value of the stock. This resulted in substantial detriment to the remaining shareholders. These shareholders filed a suit alleging violation of rule 10b-5 in that Feldmann had perpetrated a fraud in the sale of his stock. 193 F.2d at 462. The court, in denying plaintiffs’ standing, held that

the Rule in question [is] aimed only at “a fraud perpetrated upon the purchaser or seller” of securities and [has] no relation to breaches of fiduciary duty by corporate insiders resulting in fraud upon those who were not purchasers or sellers.

Id. at 463.

limitation of *Birnbaum*,⁷ while legal writers have strongly opposed them.⁸ In recent years, however, a growing trend away from a uniformly strict interpretation began to evidence itself, as courts found ways to allow deserving plaintiffs to maintain their causes of action.⁹

The Supreme Court had carefully avoided the standing issue until its ruling in *Superintendent of Insurance v. Bankers Life & Casualty Co.*,¹⁰ which undermined the substantive ruling of the *Birnbaum* court by allowing the plaintiffs to maintain a rule 10b-5 action based on corporate mismanagement tangentially related to the sale of securities.¹¹ The procedural aspects of *Birnbaum* were left intact, however, although many commentators,¹² reading the language of *Bankers Life* together with *Affiliated Ute Citizens v. United States*,¹³ believed the complete

7. *But cf.* *Eason v. General Motors Acceptance Corp.*, 490 F.2d 654 (7th Cir. 1973), *cert. denied*, 416 U.S. 960 (1974). In that case the Seventh Circuit flatly rejected *Birnbaum's* purchaser-seller standing requirement. Other courts, while paying verbal homage to the rule, have in fact stretched and molded the standing requirement to fit the particular case. *See James v. Gerber Prods. Co.*, 483 F.2d 944 (6th Cir. 1973) (trust beneficiaries); *A.T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967) (parties to incomplete transaction); *Vine v. Beneficial Fin. Co.*, 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967) (minority shareholders in short form mergers); *Hooper v. Mountain States Sec. Corp.*, 282 F.2d 195 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961) (issuers).

8. *See, e.g.*, Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268 (1968); *cf.* Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 NW. U.L. REV. 627 (1963).

9. *See* cases cited in note 7 *supra*.

10. 404 U.S. 6 (1971). This case involved a complicated scheme which resulted in Manhattan Casualty Co. essentially being stripped of its assets. Bankers Life & Casualty Co., the sole owner of Manhattan's stock, agreed to sell it all to Mr. Begole. Begole then proceeded, through a series of fraudulent transactions, to pay for the stock with Manhattan's own assets, consisting primarily of \$4.8 million worth of United States Treasury bonds. The liquidator of Manhattan then brought an action under section 10(b) on behalf of the company's creditors. The Supreme Court held that the sale of the Treasury bonds involved fraud and thus qualified under section 10(b) and rule 10b-5. In so doing, the Court gave a broad interpretation to section 10(b). The Court also used language peculiarly applicable to the present case:

Since practices "constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers" in the regulatory agency "have been found practically essential." [H.R. Rep. No. 1383, 73d Cong., 2d Sess., 7] Hence we do not read § 10(b) as narrowly as the Court of Appeals; it is not "limited to preserving the integrity of the securities markets" though that purpose is included. Section 10(b) must be read flexibly, not technically and restrictively. Since there was a "sale" of a security and since fraud was used "in connection with" it, there is redress under § 10(b), whatever might be available as a remedy under state law.

404 U.S. at 12 (citation omitted).

11. *Id.* at 9-13.

12. *See* sources cited in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 768-69 n.3 (Blackmun, J., dissenting).

13. 406 U.S. 128 (1972). In *Affiliated Ute* the Court held that in a case

demise of *Birnbaum* to be imminent. Certainly the courts did not feel constrained to follow *Birnbaum* to the letter as evidenced by the Seventh Circuit's explicit rejection of the limitation in *Eason v. General Motors Acceptance Corp.*,¹⁴ and the Ninth Circuit's enunciation of a major exception to it in 1973,¹⁵ only one year after adopting *Birnbaum* as the rule to be applied in rule 10b-5 litigation.¹⁶ In *Blue Chip* the Supreme Court reversed the position it had implicitly taken in *Bankers Life*, thus undermining the precedent authority of those cases rejecting *Birnbaum*.

The *Blue Chip* case traces its origins back to 1963 when the United States filed a complaint charging Blue Chip Stamp Company, Thrifty Drug Stores, and eight grocery chains with conspiracy to restrain trade and with monopolization of the trading stamp business in California. The case was settled by a consent decree in 1967.¹⁷ Other retailers, including Manor Drugs, which used Blue Chip stamps but owned no part of the company, appeared as amicus curiae during the proceedings and argued that the Blue Chip Stamp Company was originally intended to be a non-profit venture on behalf of all users of Blue Chip stamps and

involving primarily a failure to disclose, *positive proof of reliance is not a prerequisite to recovery*. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision.

Id. at 153-54 (emphasis added). The Court also cited language from Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971), and SEC v. Capital Gains Research Bureau, 375 U.S. 180, 186 (1963), which indicated that the securities legislation was to be construed liberally and with the idea of enforcing a philosophy of full disclosure in the securities industry. 406 U.S. at 151.

Affiliated Ute was a suit brought by mixed-blood Indians under section 10(b) and rule 10b-5 against the United States, First Security Bank of Utah (which acted as transfer agent for the Indians' stock), and two bank employees. The Court found that the bank and its employees had engaged in a systematic scheme to defraud the Indians into selling their stock at prices below the fair market value. These defendants had encouraged and created a market for this stock in the White community, had received personal gratuities and commissions from the buyers, and had failed to disclose the actual market value of the stock to the sellers.

14. 490 F.2d 654 (7th Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

15. Manor Drug Stores v. Blue Chip Stamps, 492 F.2d 136 (9th Cir. 1974), *rev'd*, 421 U.S. 723 (1975). The circuit court in *Blue Chip* briefly discussed the impracticality of proving damages in 10b-5 actions involving non-purchasers, and concluded that the *Birnbaum* standing requirement was usually a valid method of eliminating these "unprovable" suits at the outset. However, the court found that in the present situation the existence of a consent decree made it possible to objectively determine the amount of damages, and thus applying *Birnbaum* would only serve to "subordinate substance to form." *Id.* at 142.

16. Mount Clemens Indus., Inc. v. Bell, 464 F.2d 339 (9th Cir. 1972).

17. United States v. Blue Chip Stamp Co., 272 F. Supp. 432 (C.D. Cal. 1967), *aff'd sub nom.* Thrifty Shoppers Scrip Co. v. United States, 389 U.S. 580 (1968).

that they in fact owned an equitable interest in the company and in \$20,000,000 it had accumulated as profits.¹⁸

In response to these arguments, part of the consent decree provided for a reorganization of Blue Chip through which the defending stockholders were to be divested of fifty-five per cent of their interest, totaling 621,000 shares of common stock. This was to be accomplished by selling "units" of securities, consisting of one debenture and three shares of common stock. The units were to be offered to retail users of Blue Chip Stamps who had not previously held stock in the company in proportion to their use of stamps during a designated period. The selling price to these retailers was \$101.00, but the fair market value of each unit was \$315.00. Any of the units which were not purchased could later be sold on the open market by the issuer.¹⁹

It was alleged that the existing shareholders of the company attempted to discourage the new offerees from accepting this bargain offer by publishing a prospectus which minimized the value of the offering and painted a bleak picture of the financial future of the company.²⁰ Another prospectus, issued a year later when the units were offered to the public at a higher price, made no reference to these negative factors.²¹ Because the plaintiff was dissuaded from purchasing the stock as a result of the earlier misrepresentations, it brought suit seeking damages for the lost opportunity to purchase, the right to purchase at the previous price, and exemplary damages.²²

The case reached the Supreme Court on the question of whether Manor Drugs could bring an action for violation of rule 10b-5 "without having either bought or sold the securities described in the allegedly misleading prospectus."²³ The district court held that it could not and

18. For a complete summary of the history and facts of the case see *Manor Drug Stores v. Blue Chip Stamps*, 492 F.2d 136, 138-40 (9th Cir. 1974), *rev'd*, 421 U.S. 723 (1975); Comment, *Chipping Away at the Birnbaum Doctrine: Manor Drug Stores v. Blue Chip Stamps*, 8 Loy. L.A.L. Rev. 171, 179-80 (1975) [hereinafter cited as *Chipping Away*].

19. *Manor Drug Stores v. Blue Chip Stamps*, 339 F. Supp. 35, 37 (C.D. Cal. 1971), *rev'd*, 492 F.2d 136 (9th Cir. 1974), *rev'd*, 421 U.S. 723 (1975).

20. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 763-64 (Blackmun, J., dissenting). Specifically the prospectus stated that claims pending against the company aggregated approximately \$29,000,000. These claims were later settled for less than \$1,000,000. In addition, the redemption rate was estimated at 97 1/2 percent, when historically less than 90 percent were redeemed. This resulted in an understatement of earnings of about 80 percent.

21. *Id.*

22. *Id.* at 727.

23. *Id.*

dismissed the complaint accordingly.²⁴ The plaintiff, on appeal, argued only the rule 10b-5 claim.²⁵ The Ninth Circuit recognized the unique nature of the factual situation and granted the plaintiff standing, thus creating a narrow exception to the *Birnbaum* rule.²⁶ Subsequently it denied rehearing en banc and certiorari was granted.²⁷

Justice Rehnquist, writing for the majority of the Court, examined both the legislative intent and the current policy considerations relevant to rule 10b-5 cases. He concluded that although the advantages of the *Birnbaum* rule "are more difficult to articulate"²⁸ than the disadvantages, the danger of vexatious litigation and the undesirability of a case-by-case erosion of the rule required the Court to uphold the strict interpretation of the purchaser-seller requirement.²⁹

The concurring opinion,³⁰ written by Justice Powell, with whom Justices Stewart and Marshall joined, agreed with the majority, but placed greater reliance on the text of the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the 1934 Act), particularly the language of section 10b and rule 10b-5.³¹ These Justices also chose to dwell on the subjective problems of proof and class limitation. They found that the "unpredictable consequences for the process of raising capital so necessary to our economic well-being" that might accompany the demise of the *Birnbaum* rule outweighed any arguments for a flexible interpretation of the purchaser-seller limitation.³²

Justice Blackmun, joined by Justices Douglas and Brennan, dissent-

24. *Manor Drug Stores v. Blue Chip Stamps*, 339 F. Supp. 35 (C.D. Cal. 1971), *rev'd*, 492 F.2d 136 (9th Cir.1974), *rev'd*, 421 U.S. 723 (1975).

25. In the district court plaintiffs had also alleged violations of section 12 of the Securities Act of 1933, 15 U.S.C. § 77l (1970). In addition they claimed status as third party beneficiaries under the consent decree. The district court dismissed the first of these contentions, noting that section 12 "expressly limits recovery to . . . 'purchasers'" 339 F. Supp. at 38-39. With regard to the consent decree, the court stated that it was well established that

[t]he fact that the decree was intended to benefit certain non-parties does not confer on them an independent cause of action for violation of the decree.

Id. at 38.

26. *Manor Drug Stores v. Blue Chip Stamps*, 492 F.2d 136 (9th Cir. 1974), *rev'd*, 421 U.S. 723 (1975).

27. *Blue Chip Stamps v. Manor Drug Stores*, 419 U.S. 922 (1974).

28. 421 U.S. at 739.

29. *Id.* at 755.

30. *Id.* (Powell, J., concurring).

31. *E.g., id.* at 760.

32. *Id.*

ed.³³ They found the legislative history relied on by the other members of the Court to be inconclusive. The dissent attacked the facile acceptance of lower court precedence on a subject never before examined by the Court. Finally, the dissent deplored the majority's reliance on pragmatism and conjecture in reaching a conclusion which exhibited a "preternatural solicitousness for corporate well-being and a seeming callousness toward the investing public quite out of keeping . . . with our own traditions and the intent of the securities laws."³⁴

The arguments in this case epitomize the ongoing conflicts that have plagued the lower courts for twenty-three years in their attempts to delineate the proper scope of the class of plaintiffs that may bring a 10b-5 action. The opinions in *Blue Chip* highlight the two main areas of the problem: (1) the ambiguity of the legislative intent and (2) the validity of using policy considerations to expand or restrict the class of potential plaintiffs.

I. LEGISLATIVE HISTORY

Ironically, section 10(b) was one of the least controversial parts of the Securities Exchange Act of 1934.

[With] nearly a thousand pages of hearings in the House, the combined references to § 10(b) (then § 9(c)) would scarcely fill a page. Much the same [was] true in the Senate.³⁵

Yet with this dearth of legislative history which the Court admitted is inconclusive,³⁶ the majority set forth congressional intent as the major substantive justification for its opinion. As a result of the inconclusive nature of this legislative history, the Justices in *Blue Chip* appear to indulge in what may aptly be called a "quoting contest" to justify their differing opinions.

The majority opened with a discussion of the development of private suits under the 1933 and 1934 Acts and rule 10b-5.³⁷ The Court noted that the history of section 10(b) and rule 10b-5 nowhere indicates that neither Congress nor the SEC ever considered the question of private

33. *Id.* at 761 (Blackmun, J., dissenting).

34. *Id.* at 762.

35. 1 A. BROMBERG, *SECURITIES LAW: FRAUD SEC RULE 10b-5* § 2.2 (330) (1974) [hereinafter cited as BROMBERG]. Section 10(b) was originally introduced as section 9(c). S. 2693 and H.R. 7852, 73d Cong., 2d Sess. § 9(c) (1934); see 78 CONG. REC. 2267 (1934).

36. 421 U.S. at 733, 737.

37. *Id.* at 728-30.

civil remedies under these provisions.³⁸ Yet, the Court commented that beginning with *Kardon v. National Gypsum Co.*³⁹ in 1946, the lower courts had allowed private implied actions and consistently ignored the glaring contrast between the carefully drawn civil remedies of the 1933 and 1934 Acts and the catch-all nature of section 10(b).⁴⁰ This course of action was finally affirmed in *Bankers Life*,⁴¹ and was an extension of the Court's decision in *J.I. Case Co. v. Borak*⁴² that private enforcement of SEC rules "provides a necessary supplement to Commission action."⁴³

Having determined that the right of a private action under section 10(b) and rule 10b-5 had been firmly extended by judicial decision, the Court then turned to other provisions of the 1933 and 1934 Acts for guidance in determining the contours of this right. However, the majority opinion is not consistent in its analysis. On one hand the Court states that the implied private right of action must be limited to actual purchasers and sellers in view of the fact that there was "no congressional intention to extend a private civil remedy for money damages to other than defrauded purchasers or sellers."⁴⁴ Yet, in an earlier passage, the Court indicated that private suits were never contemplated by Congress.⁴⁵ Viewed in this light, the Court's professed concern for congressional intent seems somewhat hollow.⁴⁶ Further-

38. *Id.* at 729. What legislative history there is seems to indicate that Congress intended this section to be a tool of the Commission to prevent enterprising individuals from profiting by means of statutory loopholes. For a noteworthy discussion opposing private liability see Ruder, *Civil Liability under Rule 10b-5: Judicial Revision of Legislative Intent?* 57 NW. U.L. REV. 627, 642-60 (1963). But see Joseph, *Civil Liability Under Rule 10b-5—A Reply*, 59 NW. U.L. REV. 171 (1964).

39. 69 F. Supp. 512 (E.D. Pa. 1946).

40. 421 U.S. at 730.

41. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971).

42. 377 U.S. 426 (1964).

43. *Id.* at 432.

44. 421 U.S. at 731 (emphasis added).

45. *Id.* at 729.

46. There is, of course, ample judicial precedent, beginning with *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), to make the private cause of action a tacit assumption. However, the majority's equivocal language on this point creates the impression that it might not turn away from the opportunity to eliminate private enforcement of the Securities Acts entirely. In the present context, the Court focused on section 29(b) of the 1934 Act, 15 U.S.C. § 78cc (1970). Section 29(b) states that a contract made in violation of any provision of the 1934 Act is voidable at the option of the deceived party. This section has provided one of the justifications for an implied cause of action under section 10(b), 15 U.S.C. § 78j(b) (1970). Finding that there was no contract and no actual purchase or sale, the Court used this to help justify denying plaintiff's standing. See 421 U.S. at 735. The Court's reasoning is unpersuasive as it

more, the interpretation of the securities laws in *Blue Chip* represents a complete departure from the Court's previous inclination to broadly construe securities laws in order to protect investors and to provide remedies.⁴⁷

The Court attempted to glean congressional intent not so much from what Congress did in enacting section 10(b), but rather from the implications arising from congressional inaction.⁴⁸ First, the Court noted that Congress had not amended section 10(b) after *Birnbaum* although it had the opportunity to do so. Second, the Court compared the language of the section to the language used in other sections and concluded that the congressional scheme thus evidenced "support[ed] the result reached by the *Birnbaum* court."⁴⁹

In this regard it is interesting to note that the majority cited section 17(a),⁵⁰ the parallel anti-fraud provision of the 1933 Act, to support its conclusion that Congress intended to limit the class of plaintiffs in 10(b) suits to actual purchasers and sellers. Section 17(a) reaches fraud in the offer as well as in the sale of securities. This use of the word "offer" in section 17(a), when contrasted with the use of "pur-

completely ignores another basis of recovery recognized by *Kardon*, the statutory tort. See 69 F. Supp. at 514; notes 51-52 *infra*.

47. See, e.g., *Surowitz v. Hilton Hotel Corp.*, 383 U.S. 363 (1966); *J.I. Case Co. v. Borak*, 377 U.S. 426, 432, 433 (1964) ("While [the language of section 14(a) of the 1934 Act] makes no specific reference to a private right of action, among its chief purposes is the protection of investors, which certainly implies the availability of judicial relief where necessary to achieve that result. . . . [T]he duty of the courts [is] to be alert to provide such remedies as are necessary to make effective the congressional purpose."); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 197-99 (1963); *SEC v. C.M. Joiner Leasing Corp.*, 430 U.S. 344 (1944). In *Joiner* the Court stated:

[C]ourts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy.

Id. at 350-51 (footnote omitted).

48. 421 U.S. at 733.

49. *Id.*

50. *Id.* Section 17(a), 15 U.S.C. § 77q (1970), provides:

It shall be unlawful for any person *in the offer* or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(emphasis added.)

chase" in section 10(b), does create a strong inference supporting the majority's thesis. However, the opinion failed to discuss the equally viable fact that the 1933 and 1934 Acts should be read together as one comprehensive federal scheme to prevent securities frauds. In this context it would appear that Congress may have intended to prevent fraud in securities offerings as well as in actual purchases or sales. Some consideration should be given to this overall scheme when a judicially created rule of standing is arbitrarily used to eliminate recovery of damages in cases of fraudulent offerings. The Court, however, made no attempt to analyze these implications.

A significant deficiency of the majority opinion lies in its failure to recognize the alternative rationale of the implied right of action under rule 10b-5, the statutory tort. This common law doctrine allows a person injured through a violation of a statute enacted for the benefit of a class of which the injured person is a member to recover damages.⁵¹ This doctrine was relied on in *Kardon*.⁵² The *Blue Chip* Court, however, ignored this basis for liability and in the portion of the opinion in which it discussed standing it did so in terms of a contractual relationship.⁵³ Whatever the reason for this, there seems to be an underlying implication in the majority opinion that since the private right to enforce federal statutes and SEC rules is court-created, the Court upon reconsideration may revoke it.

In contrast to the majority opinion, Justice Blackmun, writing for the dissent, found it manifest that the plaintiff had alleged the use of a deceptive scheme "in connection with the purchase or sale of any

51. See 2 F. HARPER & F. JAMES, *THE LAW OF TORTS* § 17.6 (1956); W. PROSSER, *THE LAW OF TORTS* 190-204 (4th ed. 1971).

52. There the court stated:

This rule is more than merely a canon of statutory interpretation. The disregard of the command of a statute is a wrongful act and a tort. . . . "This is but an application of the maxim, *Ubi jus ibi remedium*."

Of course, the legislature may withhold from parties injured the right to recover damages arising by reason of violation of a statute but the right is so fundamental and so deeply ingrained in the law that where it is not expressly denied the intention to withhold it should appear very clearly and plainly.

69 F. Supp. at 513-14 (citation omitted).

53. 421 U.S. at 751. This contractual theory arose from section 29(b) of the 1934 Act which provides that a contract made in violation of any of the provisions of the Act is void. 15 U.S.C. § 78cc (1970). It was also discussed in *Kardon*, 69 F. Supp. at 514:

It seems to me that a statutory enactment that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it. The statute would be of little value unless a party to the contract could apply to the Courts to relieve himself of obligations under it or to escape its consequences.

69 F. Supp. at 514; see note 46 *supra*. This theory is not as frequently used as that of the statutory tort. See BROMBERG, *supra* note 28, § 2.4(1)(a)-(b).

security.”⁵⁴ Placing an emphasis on the facts of the case before the Court, which the majority all but ignored, the dissent found an anomaly in the denial of relief based on the fact that the plaintiff did not “fit into the mechanistic categories of either ‘purchaser’ or ‘seller’ when the very purpose of the alleged scheme was, to inhibit the plaintiffs from ever acquiring the status of ‘purchaser.’”⁵⁵

The dissent quoted extensively from the *Congressional Record* and other legislative sources which emphasized the broad purpose and scope which the 1934 Act was intended to have in the area of fraud. The dissent relied on the statement made by Thomas G. Corcoran, one of the drafters of the Bill, in his explanation of the section to the House Committee:

[This section] says: ‘Thou shalt not devise any other cunning devices.’ . . . Of course [it] is a catch-all clause to prevent manipulative devices[.] I do not think there is any objection to that kind of a clause. The Commission should have the authority to deal with new manipulative devices.⁵⁶

Then, noting the casual origins of rule 10b-5 and reasoning that “[to] say specifically that certain types of fraud are within Rule 10b-5, of course, is not to say that others are necessarily excluded,” the dissent concluded the essential test should be the “showing of a logical nexus between the alleged fraud and the sale or purchase of a security.”⁵⁷

In addition to attacking the Court’s interpretation of legislative intent, Blackmun criticized the majority’s unquestioning reliance on the “long-standing acceptance by the courts” and on “Congress’ failure to reject *Birnbaum’s* reasonable interpretation of the wording of section 10(b).”⁵⁸ His strongest criticism, however, was aimed at the Court’s discussion of “vexatiousness” and its reliance on policy considerations.⁵⁹

II. POLICY CONSIDERATIONS

That the *Blue Chip* majority was in fact relying on policy considerations in reaching its decision is clear. After analysis of the available

54. 421 U.S. at 764.

55. *Id.* at 765.

56. *Hearings on H.R. 7852 & H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934).

57. 421 U.S. at 770.

58. *Id.* at 769.

59. *Id.* at 769-70.

legislative intent, the Court undermined its previous arguments regarding congressional creation of the purchaser-seller requirement by stating:

[W]e would by no means be understood as suggesting that we are able to divine from the language of § 10(b) the express "intent of Congress" as to the contours of a private cause of action under Rule 10b-5.⁶⁰

As the Court was unconvinced by its own discussion of legislative intent, it decided to base its opinion purely upon "policy" considerations. Noting that a majority of commentators have found the *Birnbaum* limitation to be an "arbitrary restriction which unreasonably prevents some deserving plaintiffs from recovering damages which have in fact been caused by violations of Rule 10b-5,"⁶¹ the Court went on to state:

We have no doubt that this is indeed a disadvantage of the *Birnbaum* rule, and if it had no countervailing advantages it would be undesirable as a matter of policy, however much it might be supported by precedent and legislative history. But we are of the opinion that there are countervailing advantages to the *Birnbaum* rule, purely as a matter of policy, although those advantages are more difficult to articulate than is the disadvantage.⁶²

The Court then launched into a discussion of the vexatious nature of 10b-5 litigation. This concern of the Court for the mundane realities of the American judicial system appears⁶³ to be based on two grounds: (1) fear that even a frivolous complaint will have a settlement value out of proportion to the prospect of its success at trial;⁶⁴ and (2) fear that the proof will be too dependent on oral testimony which could be greatly abused.⁶⁵

With regard to the first ground, the Court was particularly concerned that "the very pendency of the lawsuit may frustrate or delay normal business activity,"⁶⁶ and that there is greater potential for "abuse of the liberal discovery provisions" of the Federal Rules of Civil Procedure than in other types of cases.⁶⁷ The majority found that the 1934

60. *Id.* at 737.

61. *Id.* at 738.

62. *Id.* at 738-39 (footnote omitted).

63. *Id.* at 769-70.

64. *Id.* at 740.

65. *Id.* at 743.

66. *Id.* at 740.

67. *Id.* at 741.

amendment of section 11 of the 1933 Act⁶⁸ to permit recovery of costs and attorneys' fees in the case of nuisance or "strike" suits demonstrated congressional support for this line of reasoning.⁶⁹ Since Congress itself feared the abuse of this type of litigation, the Court believed "that fact alone"⁷⁰ justified it in extending this protection against abuse through limitation of the plaintiff class. Unfortunately, the Court, in so doing, neglected to consider the logical alternative of adhering to the already defined congressional scheme of section 11 penalties.⁷¹ By merely extending these penalties to 10b-5 actions, the Court could have guarded against nuisance suits and at the same time could have achieved the more equitable result of penalizing frivolous plaintiffs, rather than following the chosen course of protecting clever defendants.⁷²

The Court was also concerned with the evidentiary problems arising from the proof of a rule 10b-5 violation when it stated that even though

[t]he Birnbaum rule undoubtedly excludes plaintiffs who have in fact been damaged by violations of Rule 10b-5 . . . it also separates in a readily demonstrable manner the group of plaintiffs who actually purchased or actually sold, and whose version of the facts is therefore more likely to be believed by the trier of fact, from the vastly larger world of potential plaintiffs who might successfully allege a claim but could seldom succeed in proving it.⁷³

68. 15 U.S.C. § 77k(e) (1970).

69. 421 U.S. at 740-41.

70. *Id.* at 741.

71. Section 11 provides in part:

In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant . . . such costs may be assessed in favor of [the prevailing] party . . . if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse [the prevailing party] for the reasonable expenses incurred by him, in connection with such suit

15 U.S.C. § 77k(e) (1970).

72. Since, as the Court has argued, private actions under section 10(b) and rule 10b-5 are judicially created rights, it would not appear unreasonable for the Court to take such a step. In addition to the section 11 penalties, which apply to the entire domestic securities section of the 1933 Act, identical penalties are found in sections 9 and 18 of the 1934 Act, 15 U.S.C. §§ 78i, 78r (1970). There is also some legal precedence for such a decision. In *Dabney v. Alleghany Corp.*, 164 F. Supp. 28 (S.D.N.Y. 1958), an action brought in part under the anti-fraud provisions of the 1933 and 1934 Acts, the Court applied the section 11 cost provisions to the first and third counts of the complaint which were brought under the 1933 Act. *Id.* at 32-33. The practical effect of this action was to make these penalties applicable to section 10(b) of the 1934 Act, on which the first count also relied.

73. 421 U.S. at 743.

Thus, the Court was particularly concerned that proof of the necessary facts, including the actual effect upon plaintiffs of the defendant's misrepresentations, would probably depend "almost entirely upon oral testimony,"⁷⁴ which would be largely uncorroborated by any demonstrable facts. It would often be impossible for the defendant to disprove the plaintiff's highly subjective version of the facts, or to offer any contradictory evidence at all.⁷⁵ Thus the jury would reach a verdict based solely on its opinion of the plaintiff's credibility, rather than on a careful weighing of the evidence.

Justice Blackmun, in his dissent, was highly critical of this approach:

[T]he Court, in my view, unfortunately mires itself in speculation and conjecture not usually seen in its opinions. In order to support an interpretation that obviously narrows a provision of the securities laws designed to be a "catch-all," the Court takes alarm at the "practical difficulties" . . . that would follow the removal of *Birnbaum's* barrier.⁷⁶

The Justice then summarized the majority's list of "dangerous vexations" and cryptically noted that the majority acted "as if all these were unknown to lawsuits taking place in America's courthouses everyday."⁷⁷ The dissent expressed a fear that the majority was essentially substituting expedience for justice. Since the Court, by predetermining which plaintiffs may and may not meet their burden of proof, created an artificial test which prevents those injured by novel forms of manipulation from recovering, Justice Blackmun stated he would follow the precedent set by *Eason*⁷⁸ and allow sensible standards of proof and of demonstrable damages to evolve to protect against frivolous law suits.

III. EFFECTS OF BLUE CHIP'S ADOPTION OF THE BIRNBAUM RULE

Although the *Blue Chip* opinion resolved with finality the disputes over the validity of the *Birnbaum* rule, and severely limited the courts' abilities to creatively extend the definitions of purchasers and sellers under this doctrine by expressly granting standing only to those plaintiffs who had actually purchased or sold, there are other problem areas which have been left undecided. These include derivative actions, the "frustrated seller" cases, the requirement of standing in injunctive relief actions, and the potential use of section 17(a) of the 1933 Act.

74. *Id.*

75. *Id.* at 746.

76. *Id.* at 769-70.

77. *Id.* at 769.

78. 490 F.2d 654 (7th Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

A. *Derivative Actions*

With regard to derivative actions the Court noted that certain groups of shareholders (specifically, those who decide not to sell their stock because of misrepresentations, and those whose stock declines in value because of corporate or insider activities which violate rule 10b-5) are "frequently . . . able to circumvent the *Birnbaum* limitation by bringing a derivative action on behalf of the corporate issuer if the latter is itself a purchaser or seller of securities."⁷⁹

The Court's noncommittal comment on this aspect of the *Birnbaum* rule indicates that it may be leaving an open window through which these particular plaintiffs can find a remedy so long as the corporation itself has standing to assert a cause of action. The advantages of this procedure are limited, however, because the plaintiffs in a derivative action normally gain no individual benefit other than the increase in the value of their stock which may result from any recovery they procure for the corporation.⁸⁰ The circuit courts have generally allowed these suits to proceed under 10b-5, even when the "deception occurred as part of a larger scheme of corporate mismanagement"⁸¹

Walner v. Friedman,⁸² a recent case dismissing a derivative action, interpreted the *Blue Chip* comment on derivative actions as "suggest[ing] that where . . . a corporation is neither a purchaser nor a seller of securities, a plaintiff who sues derivatively states no claim under Rule 10b-5."⁸³ This indicates that courts will strictly apply the *Birnbaum-Blue Chip* doctrine to derivative actions as well as individual suits.

B. *"Frustrated Sellers"*

"Frustrated seller" cases are closely akin to the derivative action. *Stockwell v. Reynolds Co.*,⁸⁴ which is often cited for its liberal construction of the words "in connection with the purchase or sale of any security," involved this type of action. It held that a plaintiff who had been

79. 421 U.S. at 738.

80. *But see* Perlman v. Feldmann, 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955); Note, *Individual Pro Rata Recovery in Stockholders' Derivative Suits*, 69 HARV. L. REV. 1314 (1956). Plaintiffs are entitled to attorney's fees if they prevail, as in other derivative suits.

81. *Rekant v. Desser*, 425 F.2d 872, 880 (5th Cir. 1970). *See also* Pappas v. Moss, 393 F.2d 865, 869 (3d Cir. 1968); *O'Neill v. Maytag*, 339 F.2d 764, 768 (2d Cir. 1964); *Hooper v. Mountain States Securities Corp.*, 282 F.2d 195 (5th Cir. 1960).

82. CCH FED. SEC. L. REP. ¶ 95,318 (S.D.N.Y. Oct. 6, 1975).

83. *Id.* at ¶ 98,612.

84. 252 F. Supp. 215 (S.D.N.Y. 1965).

fraudulently induced to defer the sale of his stock, and then after discovering the fraud sold his stock at a greater loss, may recover by showing that his loss was result of the defendant's fraud.⁸⁵ However *Stockwell* is not without limits. It has been distinguished on the grounds that it involved a "calculated and deliberate effort to induce the plaintiff, by express affirmative fraudulent misrepresentations, to retain his stock."⁸⁶ Also, fraud must be directly connected with the purchase or sale of securities by the plaintiff; thus a decline in stock value is not actionable unless accompanied by a sale.⁸⁷

*Madison Fund, Inc. v. The Charter Co.*⁸⁸ briefly discussed the effect of *Blue Chip* on *Stockwell*. The defendants argued that *Blue Chip*

impliedly establishes that any plaintiff who claims a loss resulting from his retention of stock is *per se* beyond the pale of the *Birnbaum* rule—whether or not that stock was ultimately sold.⁸⁹

The plaintiffs contended that:

Stockwell stands unshaken in the wake of *Blue Chip Stamps'* broad pronouncement that the *Birnbaum* rule "limits the class of plaintiffs to those who have at least dealt in the security to which the . . . representation . . . relates."⁹⁰

85. *Id.* at 219. In *Stockwell*, plaintiffs purchased stock in Alside, Inc. from a brokerage firm after being advised that a partner in the firm was also a director of Alside. Subsequently the plaintiffs decided to sell because of the stock's declining market value. They were dissuaded from doing this by the broker's fraudulent representations concerning Alside's financial position. They eventually sold at a greater loss than would otherwise have been realized by them. See also *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515 (8th Cir. 1973).

86. *Edelman v. Decker*, 337 F. Supp. 582, 585-86 (E.D. Pa. 1972).

87. *Id.* at 585-87. But see *Vine v. Beneficial Fin. Co.*, 374 F.2d 627, 634 (2d Cir. 1967), in which the court discussed the "forced seller" problem. Plaintiff's corporation had been merged, and he had no option other than to sell his stock to defendant. Plaintiff chose not to sell, and instead brought a 10b-5 action alleging fraud. The court noted:

It is true that appellant still has his stock; if he turned it in for the price of \$3.29 a share, it would be clearer that appellant is a seller. Assuming that this would not otherwise affect his right to sue under the Act and the Rule, requiring him to do so as a condition to suit seems a needless formality.

Id. (emphasis added). See also *Dudley v. Southeastern Factor & Fin. Corp.*, 446 F.2d 303 (5th Cir.), cert. denied sub nom, *McDaniel v. Dudley*, 404 U.S. 858 (1971); *Coffee v. Permian Corp.*, 434 F.2d 383 (5th Cir. 1970); *Crane Company v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), cert. denied, 400 U.S. 822 (1970); *Voegel v. American Sumatra Tobacco Corp.*, 421 F. Supp. 369 (D. Del. 1965). It will be interesting to watch the effect of *Blue Chip's* requirement of a "demonstrable fact" on future cases involving forced sellers.

88. CCH FED. SEC. L. REP. ¶ 95,295 (S.D.N.Y. Sept. 26, 1975).

89. *Id.* at ¶ 98,513.

90. *Id.*, citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 747 (1975).

It appears that the plaintiff's contentions in *Madison* as to the current viability of the basic premises of *Stockwell* are correct. This conclusion finds support in the *Blue Chip* opinion itself. The Court noted that one of the classes of plaintiffs barred by the *Birnbaum* rule is that of "actual shareholders . . . who allege that they decided not to sell their shares because of an unduly rosy misrepresentation or a failure to disclose" ⁹¹ At first glance this appears to overrule *Stockwell*. However, other language in the Court's opinion strongly indicates that an eventual sale of the stock is sufficient to bring frustrated sellers within the *Birnbaum* rule. For example, the Court cited to its opinion in *Affiliated Ute Citizens v. United States* ⁹² and stated that:

While the damages suffered by purchasers and sellers pursuing a § 10(b) cause of action may on occasion be difficult to ascertain . . . in the main such purchasers and sellers at least seek to base recovery on a demonstrable number of shares traded. ⁹³

The emphasis in *Blue Chip* seems to be on providing an "objectively demonstrable fact" in an area otherwise open to speculation and conjecture. ⁹⁴ A purchase or sale satisfies this requirement; however, the Court did not discuss any specific guidelines as to the necessary proximity in time between the fraud and the stock transaction. This leaves the lower courts free to formulate their own opinions in light of the general policy enunciated in *Blue Chip*. ⁹⁵

C. Injunctive Relief Actions

Another area mentioned in passing by the *Blue Chip* Court as a basis for a flexible interpretation of the *Birnbaum* rule is the action for injunctive relief. The Court noted that its decision in *SEC v. National Securities, Inc.*, ⁹⁶ "established that the purchaser-seller rule imposes no limitation on the standing of the SEC to bring actions for injunctive relief under § 10(b) and Rule 10b-5." ⁹⁷ This remedy was extended to

The court ultimately avoided deciding the issue by finding that plaintiff had had no intent to sell: "Moreover, where a 'frustrated seller' claim is made under Rule 10b-5, a clear indication of an alleged initial intention to sell is critical." *Id.* at ¶ 98,514.

91. 421 U.S. at 737-38.

92. 406 U.S. 128, 155 (1972). See note 13 *supra*.

93. 421 U.S. at 734.

94. *Id.* at 735, 747.

95. I.e., that corporations must be protected from fraudulent and irresponsible law suits.

96. 393 U.S. 453 (1969).

97. 421 U.S. at 751 n.14.

private suits in *Mutual Shares Corp. v. Genesco, Inc.*,⁹⁸ and has become the only legitimate means of allowing nonpurchasers and nonsellers to sue for relief.⁹⁹ The rationale behind this was stated in *Genesco*:

the claim for damages . . . founders both on proof of loss and . . . causal connection with the alleged violation of the Rule; on the other hand, the claim for injunctive relief largely avoids these issues, may cure harm suffered by continuing shareholders, and would afford complete relief against the Rule 10b-5 violation.¹⁰⁰

The courts thus have generally restricted equitable relief under the Act to the injunction. However, Justice Goldberg's comments in *SEC v. Capital Gains Bureau*,¹⁰¹ a suit brought under the Investment Advisors Act of 1940, indicates that this exception to *Birnbaum* might not be limited to injunctions. He stated: "It is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages."¹⁰² This comment tends to open the door for suits based on other forms of equitable relief, such as rescission and restitution. Adopting similar reasoning, several courts have allowed nontraders to sue for equitable relief.¹⁰³

However, *Vincent v. Moench*, which stated that a showing of "causal connection between the fraudulent sale of a security and [an] injury" was sufficient to sustain federal jurisdiction in a suit for equitable relief,¹⁰⁴ placed a great deal of emphasis on its reading of *Bankers Life*, which it found supported the "trend in federal courts away from a strict application of the purchaser-seller rule."¹⁰⁵ *Blue Chip* has since destroyed the viability of this reasoning but not necessarily the conclusion. *Federal Savings and Loan Ins. Corp. v. Fielding*,¹⁰⁶ in upholding fed-

98. 384 F.2d 540, 547 (2d Cir. 1967).

99. E.g., *Vincent v. Moench*, 473 F.2d 430, 434 (10th Cir. 1973); *GAF Corp. v. Milstein*, 453 F.2d 709, 721 (2d Cir. 1971), cert. denied, 406 U.S. 910 (1972); *Kahan v. Rosenstiel*, 424 F.2d 161, 170-71, 173, (3d Cir.), cert. denied sub nom., *Glen Alden Corp. v. Kahan*, 398 U.S. 950 (1970).

100. 384 F.2d at 547.

101. 375 U.S. 180, 193 (1963).

102. *Id.* (emphasis added).

103. *Vincent v. Moench*, 473 F.2d 430, 434 (10th Cir. 1973); *Young v. Seaboard Corp.*, 360 F. Supp. 490, 492 (D. Utah 1973); *Federal Sav. & Loan Ins. Corp. v. Fielding*, 309 F. Supp. 1146, 1154 (D. Nev. 1969), cert. denied, 400 U.S. 1009 (1971); *Janigan v. Taylor*, 344 F.2d 781 (1st Cir. 1965) (which applied the theory of unjust enrichment to require a defrauding buyer of stock in violation of rule 10b-5 to return his profits to the seller).

104. 473 F.2d at 435.

105. *Id.* at 434.

106. 309 F. Supp. 1146 (D. Nev. 1969).

eral jurisdiction despite the plaintiff's failure to either purchase or sell, noted that, "We cannot . . . ignore the broad statutory grant of equitable jurisdiction to the district courts to secure compliance with the regulations."¹⁰⁷ This court analogized the Securities Exchange Act with the Fair Labor Standards Act and followed the precedents for granting equitable relief under the latter, concluding that "restitution is a possible form of relief under the case made by the Complaint."¹⁰⁸

The future of this exception to the *Birnbaum* rule is unclear in light of *Blue Chip*. While the equitable relief of returning an injured plaintiff to his former position is distinguishable from an action at law for damages, *Blue Chip's* concern for demonstrable facts in damage actions is easily extendable to any monetary form of equitable relief. Certainly the same fears of strike suits, fraud, abuse of oral testimony, and difficulty of proof would be applicable in many instances. In addition, the *Blue Chip* Court specifically rejected the causation rule enunciated by the dissent,¹⁰⁹ and relied on in *Vincent*.

D. Section 17(a) Suits

Other questions arising in *Blue Chip's* wake concern the future viability of private causes of action under section 17(a) of the 1933 Act. The *Blue Chip* court found this section significant, noting:

The wording of §10(b) directed at "fraud in connection with the purchase or sale" of securities stands in contrast with the parallel antifraud provision of the 1933 Act, §17(a) . . . reaching fraud "in the offer or sale" of securities.¹¹⁰

This language appears to indicate that section 17(a) may provide a future means of avoiding the strict *Birnbaum* doctrine in the area of stock offerings. However, the Court specifically refused to express an opinion as to whether the section "gives rise to an implied cause of action."¹¹¹

The use of section 17(a) is not new, although it has generally been overshadowed by the more popular 10b-5 action. In fact, most courts have recognized that a private cause of action exists under this sec-

107. 309 F. Supp. at 1152.

108. *Id.* at 1152-54.

109. 421 U.S. at 736-37 n.8.

110. *Id.* at 733-34.

111. *Id.* at n.6.

tion.¹¹² *Fischman v. Raytheon Mfg. Co.*,¹¹³ in discussing *inter alia* the requirements of a suit brought under section 11 of the 1933 Act,¹¹⁴ noted that a section 17(a) suit could stand independently of a section 11 suit, so long as it contained adequate allegations of fraud. In making this statement, the court appeared to be influenced by its similarity to section 10(b).¹¹⁵

On the other hand, *Greater Iowa Corp. v. McLendon*¹¹⁶ found that congressional intent clearly indicated that private civil liability under section 17(a) existed only when the provisions of section 12¹¹⁷ were met. Under this interpretation, the 17(a) standing requirement is stricter than that enunciated in *Birnbaum*.

Judge Friendly noted that section 17(a) was intended

only to afford a basis for injunctive relief and, on a proper showing, for criminal liability, and was never believed to supplement the actions for damages provided by §11 and §12.¹¹⁸

However, he went on to state that once buyers were given a private cause of action under section 10(b) there was little reason for prohibiting such actions under section 17, as long as fraud was alleged. Louis Loss, in his three volume treatise,¹¹⁹ also disapproves private actions under 17(a), finding them to be quite out of keeping with the purpose of the 1933 Act.

It is certainly not insignificant that the *Blue Chip* court cited to the above sources while refusing to advance an opinion on the question they raise. Despite numerous case decisions supporting the private cause of action, the Court, with one exception, cited authorities which were critical of the approach and emphasized the limits on liability established under sections 11 and 12. In light of the strict interpretation of *Birnbaum*, and the Court's other efforts to limit the rapidly expanding area of liability under the securities laws, it appears that a strict re-

112. Jacobs, *Birnbaum in Flux: Significant 10b-5 Developments*, 7 SEC. L. REV. 403, 414 (1975). See, e.g., *Hanraty v. Ostertag*, 470 F.2d 1096, 1098 (10th Cir. 1972); *Kellman v. ICS, Inc.*, 447 F.2d 1305, 1308 (6th Cir. 1971); *Dack v. Shanman*, 227 F. Supp. 26, 28-29 (S.D.N.Y. 1964).

113. 188 F.2d 783, 787 (2d Cir. 1951).

114. 15 U.S.C. § 77k (1970).

115. 188 F.2d at 787 n.2.

116. 378 F.2d 783, 790 (8th Cir. 1967).

117. 15 U.S.C. § 77l (1970). This section limits recovery to defrauded purchasers.

118. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968) (concurring opinion), cert. denied, 394 U.S. 976 (1969). Cf. *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783, 787 n.4 (2d Cir. 1951).

119. 3 L. LOSS, SECURITIES REGULATION 1785 (1961).

examination of implied private actions under the 1933 Act may be imminent.

IV. CONCLUSION

The effect of the *Blue Chip* decision on suits brought under other sections of the 1933 and 1934 Acts may be pervasive. Certainly it would be consistent to extend the *Birnbaum* rule to all such damage actions, as the *Blue Chip* Court seemed particularly concerned with the pragmatic effects of the rule as both a bar to frivolous litigation and as a satisfactory method of predetermining which plaintiffs could meet the burden of proving damages. In fact, the value of the rule would be greatly dissipated if ingenious counsel were allowed to avoid it by alleging violations of other sections of the Acts. *Myers v. American Leisure Time Enterprises Inc.*¹²⁰ is a recent case which confronts this issue. Plaintiffs asserted a cause of action under section 13(d) of the 1934 Act¹²¹ which requires the filing of certain reports by those who acquire directly or indirectly the beneficial ownership of more than five percent of a class of registered equitable security. Plaintiffs sought to avoid the purchaser-seller requirement of section 18¹²² by claiming to have an implied right of action under section 13(d) which did "not turn on their status as purchasers or sellers."¹²³ The court held that:

Although there is no authority restricting standing in suits under § 13(d) to plaintiffs who are purchasers or sellers, such a holding would seem to follow logically as an extension of the Supreme Court's holding in *Manor Drug Stores*. . . . To allow suits by mere holders of securities in such cases would be to allow the plaintiffs to circumvent the *Birnbaum* doctrine in many cases simply by casting their complaint to include alleged violations of § 13(d). This of course would be contrary to the spirit, if not the letter, of the *Manor Drug Stores* decision.¹²⁴

With the now permanent entrenchment of *Birnbaum* in the federal securities laws, many similar rulings may be expected.

As the concurring opinion notes, the 1933 and 1934 Acts were written to protect investors from the puffing and overselling of the

120. CCH FED. SEC. L. REP. ¶ 95,286 (S.D.N.Y. Aug. 18, 1975).

121. 15 U.S.C. § 78m(d) (1970).

122. 15 U.S.C. § 78r (1970). This section provides that one who makes a false or misleading statement in a document filed pursuant to the statute shall be liable only to those persons who purchased or sold securities in reliance thereon.

123. CCH FED. SEC. L. REP. ¶ 95,286 at 98,465.

124. *Id.* at 98,466.

1920's and 1930's.¹²⁵ Thus, the elimination of misleading overstatement of the issuer's prospects was one of the primary targets of the Acts. The basic question becomes whether the courts should interpret these acts as prohibitions against securities fraud in general and extend their protections to investors in today's complex securities market, or whether the courts should limit the scope of the acts to situations more nearly akin to those which prompted their enactments. Already a broad spectrum of private rights has mushroomed under the federal securities laws,¹²⁶ making the latter course seem somewhat impractical.

Blue Chip placed the Court in an interesting dilemma: private rights under section 10(b) of the 1934 Act had escaped irretrievably from the limitations which Congress most likely intended to be placed on that section. This foreclosed any opportunity to return to the apparent intentions of the 1933 and 1934 Acts. Instead of allowing the effectiveness of the acts to continue to expand along with the modern securities markets, the Court decided to draw the line and maintain its conception of the status quo.

In *Blue Chip* the majority was faced with a novel divergence from the usual pattern of securities frauds. Rather than rushing to battle against the "varieties and complexities of fraud which are possible in the contemporary securities markets,"¹²⁷ the Court chose instead to stand by the inflexible *Birnbaum* doctrine. Rather than reading legislative intent as transcending the particular frauds of the 1930's and preventing securities frauds in general, the Court ignored the unremedied wrong and the portmanteau nature of section 10(b) and instead offered an open door to ingenious defrauders.

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125. 421 U.S. at 759-60 n.4.

126. Lowenfels, *Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268, 275 (1968).

127. *Id.* at 276.